

U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

OFFICE OF AFFORDABLE HOUSING PRESERVATION

MARK-TO-MARKET PROGRAM

FINAL REPORT

ON

COMPLIANCE AUDITS AND AGREED-UPON PROCEDURES REVIEWS

OF

PARTICIPATING ADMINISTRATIVE ENTITIES

FOR THE SEVENTEEN MONTHS ENDED MAY 31, 2004

March 31, 2005



OFFICE OF AFFORDABLE HOUSING PRESERVATION MARK-TO-MARKET PROGRAM

Regis & Associates, PC

Contract Number: C-ATL-01769

Date of Order: June 25, 2004

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INTRODUCTION

Introduction

The Multifamily Assisted Housing Reform and Affordability Act of 1997 (MAHRA) established the Mark-to-Market (M2M) Program as a vehicle for restructuring certain multifamily properties insured by the Federal Housing Administration when their housing assistance contracts expire. The Office of Multifamily Housing Assistance Restructuring (OMHAR) was created at that time to administer the M2M program. The H.R. 3061/Public Law 107-116 extended OMHAR through September 30, 2004. The M2M Program will continue taking new referrals through September 30, 2006 and will continue the restructuring process on these referrals until complete. Effective October 1, 2004, with the legislative sunset of OMHAR on September 30, 2004, the Department of Housing and Urban Development (HUD) established a new office, the Office of Affordable Housing Preservation (OAHP), to continue administering the M2M Program.

The M2M Program's documentation and administrative procedures were established under OMHAR, and most of the properties involved in the M2M Program were processed under OMHAR. The administrative change from OMHAR to OAHP did not result in any changes to the policies and operating procedures previously established under OMHAR. Accordingly, the names OMHAR and OAHP are used interchangeably in this report.

OAHP currently administers the M2M Program and, as such, has many responsibilities including the accountability for and monitoring of the restructuring activities. The restructuring activities are performed by private and public Participating Administrative Entities (PAEs) pursuant to a Portfolio Restructuring Agreement (PRA) between OAHP and each PAE. PAEs develop and implement restructuring plans to determine market rents, identify improvements necessary for properties to be competitive in the marketplace, and identify methods of restructuring the finances of properties, if needed, to make operating at comparable market rents financially feasible.

As part of its monitoring responsibilities, OAHP engaged Regis & Associates, PC to perform special-purpose compliance audits (compliance audits) and agreed-upon procedures (AUP) reviews of the PAEs. The purpose of these assessments was to evaluate the performance of PAEs in the M2M Program in accordance with the Operating Procedures Guide (OPG), the PRA, and the MAHRA.

In performing this engagement, OAHP requested a review of all PAEs that had restructuring transactions that were accepted by the PAE and for which restructuring plans were approved by OAHP between January 1, 2003 and May 31, 2004. In this regard, we visited 17 PAEs and tested 116 Full restructuring transactions. We conducted seven compliance audits and ten AUP reviews. We performed 28,350 test procedures and identified 147 occurrences of noncompliance. We reported these findings to OAHP and the PAEs upon completion of each engagement.



EXECUTIVE SUMMARY

Overview

The Office of Affordable Housing Preservation (OAHP), an office within the Department of Housing and Urban Development (HUD), engaged Regis & Associates, PC to perform special purpose compliance audits (compliance audits) and agreed-upon procedures (AUP) reviews of Participating Administrative Entities (PAEs). These assessments, which supplement OAHP's monitoring activities, evaluate the performance of Participating Administrative Entities in the Mark-to-Market (M2M) Program.

The compliance audits required an assessment of the risks associated with PAE noncompliance, an evaluation of the PAE internal controls, and the performance of audit procedures. The AUP reviews required the performance of test procedures agreed to by OAHP. The objective of both engagements was to determine whether the PAEs were operating in accordance with the M2M Program's Operating Procedures Guide (OPG), the Portfolio Restructuring Agreement (PRA), the Multifamily Assisted Housing Reform and Affordability Act of 1997 (MAHRA), and the Mark-to-Market Extension Act of 2001. Based on OAHP's request, we tested all PAEs that had restructuring transactions (assets) meeting pre-defined selection criteria. The criteria included transactions that were accepted by the PAE and which had their restructuring plans approved by OAHP between January 1, 2003 and May 31, 2004. Our work was performed at 17 PAEs on a statistically selected sample of 116 assets in the M2M Program portfolio. We conducted compliance audits on seven of the PAEs and AUP reviews on ten of the PAEs.

At OAHP's request, we reviewed one additional PAE, which had an approved and closed transaction. This transaction was not statistically selected, and was a restructuring transaction that met a secondary criterion of being approved during the period January 1, 2003 to May 31, 2004, and which subsequently closed. As described in Appendix E, since the scope of this additional review was not consistent with the other 17 PAEs, we did not include the results of that review in this final report, however we provided the results in a separate report that was presented to the PAE and to OAHP.

We applied the procedures documented in OAHP's *Agreed-Upon Procedures Workplan Checklist* to test both the compliance audits and AUP reviews. As a part of our design of the compliance audit procedures, we identified and correlated the relevant sections of 24CFR§401 to the requirements of the OPG, the PRA, and the MAHRA. All of these procedures were designed to obtain reasonable

assurance that the PAEs were executing the restructuring process in accordance with the requirements of the M2M Program.

Under the M2M Program, an asset restructuring is comprised of a series of tasks that a PAE must undertake. We tested these tasks (also referred to as attributes) for completeness and organization of the three main product files, procedural compliance with 11 processes, adherence to procurement policies, and accuracy of event dates as described in the Statement of Work. A detailed description of the attributes and the results of the findings are listed in the *Nationwide Results* section and Appendix D of this report. This technical approach facilitated not only the determination of compliance with the OPG, the PRA, and the MAHRA but also the identification of weaknesses that might adversely affect a PAE's performance and reporting relating to the M2M Program.

We projected the results of our tests to the asset and the PAE population as a whole. The cumulative results of our test work provide a significant perspective on the PAEs' compliance with the requirements of the restructuring process, as articulated in the laws, regulations, and guidelines for the M2M Program. In addition, they provide a perspective on the adequacy of OAHP's monitoring of the M2M Program.

Based on the attributes tested, we estimate that timeline reporting had a compliance rate of 93%, project files products had a compliance rate ranging from 96% to 100%, and administrative processes had a compliance rate ranging from 90% to 100%. The compliance rates identified above, based on a 99% confidence level of the results, indicate that the PAEs are substantially adhering to the requirements of the OPG, the PRA, and the MAHRA on a nationwide basis. Furthermore, these results indicate that OAHP is effectively monitoring the PAEs' restructuring activities. The results of the tests performed indicate occurrences of noncompliance with the OPG, the PRA, and the MAHRA, based on the provisions of 24CFR§401. These occurrences of noncompliance relate to stipulated timeline failures, incomplete project files, and administrative process failures, which are reported in the *Recommendations* section of this report. Details of these findings are discussed in the *Review Findings* section of this report.



Results in Brief

Although the results of our test work revealed management practices and conditions that could be improved, we noted overall general compliance with the M2M Program's requirements. Moreover, we also noted a willingness by OAHP and the PAEs to improve the efficiency and effectiveness of the M2M Program's management.

In performing this engagement, we visited 17 PAEs and tested 116 Full restructuring transactions (assets). For these 17 PAEs visited, we conducted seven compliance audits and ten AUP reviews. We performed 28,350 test procedures and identified 147 occurrences of noncompliance. Specifically these include:

- At the asset level, we performed 27,840 test procedures and identified 141 occurrences of noncompliance. These 141 occurrences of noncompliance consisted of 63 occurrences in the compliance audits and 78 occurrences in the AUP reviews.
- At the PAE organization level, we performed an additional 510 test procedures and identified six occurrences of noncompliance.

As illustrated in Table 6 and described in Appendix A, the overall error rate attributable to these 147 occurrences of noncompliance equates to 1.08%.

We reported these findings to OAHP and the PAEs upon completion of each PAE AUP review or compliance audit engagement.

We have classified the occurrences of noncompliance into three classes of program risk. These risk classes are *Reporting Timelines*, *Project File Products*, *and Administrative Processes*. They are discussed in the *Results* section of this report.

The overall results of our test work indicate that the predominance of findings relates to missing documentation in the project files. Generally, the missing documents provide independent support for restructuring plan assumptions or may represent agreement of parties to various elements of the plan. The second most frequent group of findings relates to completion of restructuring tasks within the OPG and PRA specified timelines. These findings represent a financial cost to OAHP because Section 8 rent subsidies, in many cases, are continued at above-market rates until a restructuring transaction reaches completion. The remaining findings relate to the failure of PAEs to maintain adequate documentation in the administrative process and oversight of third-party contracts as prescribed in the PRA.

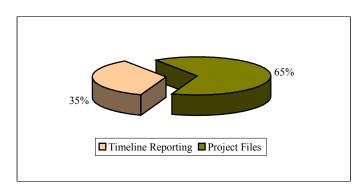


Figure 1: Analysis of Compliance Audit Findings (Asset Level)

We have illustrated the distribution of the 63 occurrences at the asset level for the seven compliance audits in Figure 1 above. Thirty five percent (22 occurrences) relate to Reporting Timelines and 65% percent (41 occurrences) relate to Incomplete Project File Products.

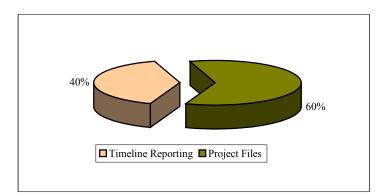


Figure 2: Analysis of AUP Review Findings (Asset Level)

We have illustrated the distribution of the 78 occurrences at the asset level for the 10 AUP Reviews in Figure 2 above. Forty percent (31 occurrences) relate to Reporting Timelines and 60% (47 occurrences) relate to Incomplete Project File Products.



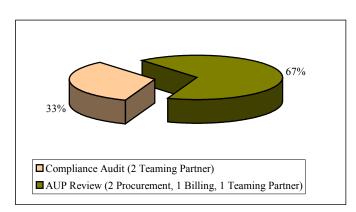


Figure 3: Analysis of Compliance Audit and AUP Review Findings (PAE Organizational Level)

At the PAE organizational level, we have illustrated the distribution of findings relating to both compliance audits and AUP reviews in Figure 3 above. Of the six occurrences of noncompliance, 33% (2 occurrences) relate to compliance audits and 67% (4 occurrences) relate to AUP reviews.

We present further details of these findings and the associated risks in the *Review Results* section of this report.



BACKGROUND, OBJECTIVES, & SCOPE

Background

As part of its housing mission, the Department of Housing and Urban Development (HUD) is charged with increasing the availability of decent, safe, and affordable rental housing nationally. In recent years, the cost of rental housing has increased significantly, and a considerable percentage of low and very-low-income renters have been forced to spend a disproportionate amount of their income on basic housing needs.

More than 25 years ago, in an effort to spur the construction of affordable housing and encourage private owners to participate in its *Project-Based Section 8 Program*, HUD entered into long-term contracts with property owners, which provided for annual rent increases. These increases were automatic regardless of prevailing market rents. As a result of the automatic rent increases under the Section 8 Program, many of these properties charge rents at amounts higher than prevailing market rent. This results in excessive expenditures of funds for HUD's Section 8 Program. The original housing rental subsidy contracts on thousands of privately owned multifamily properties with FHA-insured mortgages have expired over the last several years. To help ensure that the federal taxpayer is not paying more for this program than the marketplace requires, the Markto-Market (M2M) Program was created to reduce federal spending on housing subsidies. The reduction is accomplished through restructuring, making it financially feasible for multifamily properties currently charging rents greater than comparable market rents to survive and continue to offer quality, market-competitive housing at comparable market rents.

The Multifamily Assisted Housing Reform and Affordability Act of 1997 (MAHRA) established the M2M Program as a vehicle for restructuring multifamily properties insured by the FHA when the existing housing assistance contracts expire. The Office of Affordable Housing Preservation (OAHP), an office within HUD, administers the M2M Program and, as such, has many responsibilities, including monitoring of the restructuring activities. In keeping with HUD's mission and its objective of increasing the availability of decent, safe, and affordable rental housing, the major goals of the M2M Program are:

- Social: Preserving affordable housing stock by maintaining the long-term physical and financial integrity of privately owned, HUD subsidized rental housing insured by FHA;
- Economic: Reducing the long term project based Section 8 rental assistance costs and reducing the cost of mortgage insurance claims paid by FHA; and

• Administrative: Establishing a nationwide network of locally-based PAEs to administer the M2M Program, promoting greater operating and cost efficiencies in the Section 8 assisted properties, and addressing problem properties by terminating relationships with owners who violate Program agreements and requirements.

When Section 8 contracts at above-market rents expire, OAHP reduces rents to market levels and, where needed, restructures the existing mortgage debt to levels supportable at the lower rents. As required by MAHRA, OAHP solicited and selected capable organizations, referred to as Participating Administrative Entities (PAEs), to assist in the restructuring process. The PAEs were selected through a qualifying process and are classified as either Public or Private (Non-Public) entities. The Public PAEs are comprised of state and local housing finance agencies, whereas the Private PAEs consist of both not-forprofit and for-profit entities. The Private PAEs are usually contracted by OAHP to perform restructurings on eligible properties outside of the state and local housing finance agencies' jurisdictions. The PAEs' duties are restricted to restructuring activities pursuant to a Portfolio Restructuring Agreement (PRA) between OAHP and each PAE. The PAEs develop restructuring plans to determine appropriate market rents, identify any improvements necessary for the property to become competitive in the marketplace, and identify methods for restructuring the finances of the property, if needed, to make operating at market rents financially feasible.

OAHP is responsible for the evaluation and monitoring of the PAEs to ensure compliance with the M2M Program. To achieve this objective, OAHP developed, and continually updates, the M2M Program Operating Procedures Guide (OPG) that sets forth the uniform process for restructuring FHA-insured Section 8 housing projects. In addition, OAHP developed the M2M Program's Agreed-*Upon Procedures Checklist* as a tool for evaluating the PAEs adherence to the requirements of the OPG, the PRA, and the MAHRA. OAHP also relies on the results of other audits for the evaluation of the PAEs, such as OMB Circular A-133 Audits, Federal Contract Audits, and other reviews. Finally, OAHP retains independent auditors to evaluate and report on the PAEs' adherence to the requirements of the M2M Program.

There are two major types of restructuring transactions - a mortgage debt restructuring transaction (Full) and a rent restructuring transaction (Lite).

Mortgage debt-restructuring transactions, known as "Fulls", occur when the PAEs develop restructuring plans that include reduction of

rents to market levels and restructured mortgage financing. These plans are approved by OAHP when all the established criteria are satisfied. The Full mortgage debt restructuring also involves a thirty-year Use Agreement.

Rent restructuring transactions, known as "Lites", occur when the PAEs develop restructuring plans that reduce rents to market levels without refinancing the mortgage debt. A Use Agreement is not required for Lites. OAHP approves the restructurings once it determines that the long-term physical and financial integrity of the property would not be jeopardized.

In its July 2001 *Report to Congressional Committees*, the U.S. General Accounting Office reported OAHP's estimation that the M2M Program would save the federal government \$563 million over 20 years on properties that were restructured as of June 15, 2001. According to OAHP's current estimate, the PAEs had completed 2,643 transactions as of April 30, 2005, with total projected savings of \$1.5 billion over 20 years.

Objectives, Scope, and Methodology

OAHP engaged Regis & Associates, PC to perform compliance audits and AUP reviews of PAEs to enhance its oversight and evaluation of these organizations under the M2M Program. The focus of our work was to determine whether the PAEs complied with the major requirements of the PRA, the OPG, and the significant provisions of applicable laws and regulations during the period January 1, 2003 to May 31, 2004. Regis & Associates, PC was not engaged to form a judgment as to the economic benefits or worth of the restructuring transactions that have been executed. Moreover, our report does not provide a legal determination of PAEs' compliance with the requirements identified above. Our work was designed to test procedural compliance with these requirements. In addition, the evaluation addressed the following secondary objectives:

- 1. The determination of the completeness and organization of the product files as required by the PRA and OPG.
- 2. The determination of the completeness of data and procedural compliance with the processes required by the PRA and OPG.
- 3. The determination of the accuracy of the event dates in the PAEs' documents and the MIS tracking reports.

OAHP's intent was to review each PAE that had an active portfolio of current restructuring transactions. This resulted in an expanded scope to include full restructuring transactions (assets) that were accepted and approved between the period January 1, 2003 and May 31, 2004. This resulted in the selection of 17 PAEs from which we then statistically selected an overall sample of 116 Full restructuring transactions with a sampling rate ranging from 100% (for PAEs having fewer than 4 eligible properties) to 33% (for PAEs having more than 4 eligible properties). We determined that visiting the 17 PAEs and sampling 116 restructuring transactions would provide sufficient data to compute average exceptions with a 99% confidence interval. Our selected sample of 116 Full transactions comprised both "Closed" and "Action Other Than Closing" (AOTC) Full transactions.

We reviewed applicable laws, implementing regulations, policies, and pertinent documents in order to obtain an understanding of the M2M Program, its requirements, and the PAE's and OAHP's responsibilities. We reviewed *OAHP's Agreed-Upon Procedures Workplan Checklist* and designed additional procedures for the compliance audits.

¹ See Sampling Methodology Document at Appendix A



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We conducted our fieldwork from July 2004 through March 2005 in accordance with auditing standards generally accepted in the United States and *Government Auditing Standards*, issued by the Comptroller General of the United States, the procedures referenced in the OPG, the PRA, and the *AUP Workplan Checklist* developed by OAHP.

We coordinated our fieldwork with OAHP and interviewed the PAEs' officials designated as our contacts for the compliance audits and AUP reviews. We designed these interviews to obtain an understanding of the PAEs' policies and procedures for internal control, procurement, training, and file maintenance that affect their operations in the M2M Program. We requested that the PAEs provide documents and information on the performance of the required restructuring activities for the selected assets. We obtained confirmation that the documents and files provided were accurate and complete. The data requested and evaluated for compliance included:

- 1. Documents constituting the credit file, contract file, and closing file.
- 2. Documents detailing the eleven primary processes in the PAEs' restructuring function; namely, training, conflict of interest notifications, owner eligibility reviews, tenant/owner meetings and required notices, due diligence/data collection, underwriting, restructure approvals, closing, documentation distribution and conversion, procurement processes/oversight of third party contractors, and OAHP invoicing.
- 3. Documents detailing the dates that events occurred as indicated in the PAEs' file documents and the MIS tracking reports.

We reviewed and tested the restructuring records and other evidential matter attesting to the PAEs' restructuring activities. In addition, we assessed the PAEs' risk of noncompliance, evaluated their internal controls, and performed other audit procedures in conducting the seven compliance audits. The objectives of the audits were to test the PAEs' compliance with the significant provisions of 24CFR §401, to identify instances of noncompliance, and to provide reasonable assurance of compliance with the M2M Program.

At the completion of fieldwork at the PAE's site, we briefed OAHP and the PAE officials on the results of our work. Additionally, we provided each PAE with a draft report and the opportunity to comment on the results. We prepared individual reports detailing the results, which presented our findings, recommendations, and the PAE's responses on the compliance audits and AUP reviews performed for the 17 PAEs. This final report on compliance audits and AUP reviews

represents the projected results of the test work from our sample of 116 Full restructuring transactions. It describes our execution of the compliance audits and AUP reviews and statistically summarizes the results by review category. Our report concludes with recommendations designed to enhance the efficiency of the Program's operations and other matters, which require OAHP's attention.



RESULTS

PAE Profile

Based on a population of 342 "Full" restructurings (assets) that were "accepted" and "approved", we conducted 17 PAE reviews, as illustrated in Table 1 below. We performed seven compliance audits and ten AUP reviews. We selected a sample of 116 assets comprising 47 and 69 Full transactions for the compliance audits and AUP reviews, respectively.

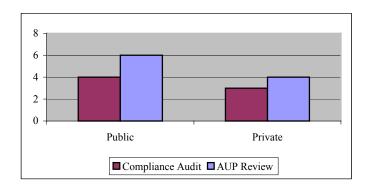
Table 1: Sample Selected and Result Statistics

	Type of		
	Audit	AUP Review	Total
PAEs Reviewed	7	10	17
Population of Full Assets	-	-	342
Full Assets Reviewed	47	69	116
Occurrences of Noncompliance	65	82	147

The work performed, and the results thereof, are based on asset sample coverage of approximately 34%.²

Our PAE sample included ten public and seven private PAEs. As illustrated in Figure 4 below, the ten public PAEs reviewed were distributed into four compliance audits and six AUP reviews, while the seven private PAEs were distributed into three compliance audits and four AUP reviews.

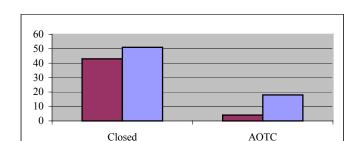
Figure 4: Types of PAEs Tested



² See Sampling Methodology Document at Appendix A



Of the 116 assets tested, 94 were "Closed" and 22 were "Action Other Than Closing" (AOTC). As illustrated in Figure 5, we tested 43 "Closed" assets and 4 "AOTC" assets as part of the compliance audits and tested 51 "Closed" assets and 18 "AOTC" assets as part of the AUP reviews.



■ Compliance Audit ■ AUP Review

Figure 5: Full Restructuring Assets Tested

Review Findings

During our compliance audits and AUP reviews, we noted management practices and conditions that could be improved thereby enhancing the efficiency and effectiveness of the Program. We reported our findings and other matters for consideration to OAHP and each PAE in the individual review reports.

In this report, we have classified the findings and their frequency into three classes of noncompliance, as identified below:

Class 1 - Findings of Noncompliance in the Reporting Timelines

Class 2 - Findings of Noncompliance in the Project Files

Class 3 - Findings of Noncompliance in the Administrative Process

We report these findings based on the nature of the engagement in which they were identified.

Class 1 – Reporting Timelines

Class 1 comprises findings of noncompliance with applicable M2M Program policies for stipulated timelines. These timelines relate to the performance of certain required activities in the restructuring process. The results of our test work indicated that the overall compliance rate was 93.2%. Alternatively, this equates to a noncompliance rate of 6.8%, which represent 53 occurrences. As shown in Table 2, of the 116 assets tested, the frequency of noncompliance with stipulated timelines ranged from 4 to 20 occurrences within four specific categories. The distribution of these findings into categories within timeline reporting phases in critical dates tracking is presented in Figure 6. These findings relate to closing docket submission within 65 days, Second tenant meetings held within ten days of plan submission, closing completion in 12 months (365 days), and plan submission in 210 days. All of these findings relate to specific requirements, each of which has significant effects on the restructuring process.

The closing process for a restructuring generates a large number of legal documents necessary to define each party's rights and obligations and to record them with the local or state governments. In order to close a transaction promptly, it is necessary for the PAE to assemble the final closing documents and submit them to OAHP within the 65-day limit as specified in Section 8-2 D, Chapter 8 of the OPG. PAEs may distribute recorded documents later, provided they include a copy of the non-recorded document in the closing docket. Failure to provide the Hubs and Program Centers with key provisions of the transaction may limit project management's ability to provide timely information on restructured assets.

The failure to hold the second tenants meeting not less than 10 days prior to submitting the restructuring plan deprives tenants of their final opportunity to review the plan and present any additional issues for inclusion. It is HUD's and OAHP's policy to accord tenants the maximum opportunity for consideration of their comments. Section 1-4, Chapter 1 and Section 3-9 D.1, Chapter 3 of the OPG, derived from 24CFR§401.500, were established to accord the PAE enough time to consider any final tenant concerns, modify the plan as necessary, and submit the plan to OAHP in a timely manner.

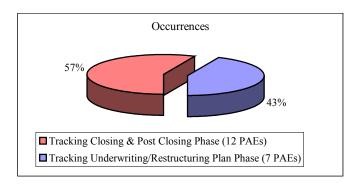
Article 5.7.1 of the PRA requires the PAE to complete closing within 12 months of the date that the property was assigned to the PAE for restructuring. Failure to close a property within the 365-day limit may necessitate additional Section 8 expenditures until the restructuring is complete.

Article 5.7.1 of the PRA also requires the PAE to submit the restructuring plan within the 210-day limit of the date that the property was assigned for restructuring. Failure by the PAE to meet the specified timeline may affect the PAE's ability to close within 365 days, as required.

Table 2: Class 1 – Reporting Timeline Findings

Types of Timeline Findings	Critical Date Tracking Phase	No. Of Occur- rences
OPG Timeline Requirement		
A: PAEs did not submit closing docket within	Closing/Post	
65 days of transaction closing	Closing	20
B : PAEs did not hold the second tenant meeting	Underwriting/	
at least 10 days prior submission of the	Restructuring	19
restructuring plan.	Plan	
PRA Timeline Requirement		
C: PAEs did not close the transaction within 365	Closing/Post	
days from the assignment date.	Closing	10
D : PAEs did not submit the restructuring plan	Underwriting/	
within 210 days from the assignment date.	Restructuring	4
	Plan	
Total Occurrences	•	53

Figure 6: Class 1 – Occurrences by Timeline Reporting Phase



As illustrated in Table 2 above, for the four timeline requirement categories, we identified 53 occurrences of noncompliance. The distribution of these occurrences of noncompliance are illustrated in Figure 6 above and indicates that 57% (30 occurrences) relate to failures in tracking timeline requirements in the Closing/Post Closing phase. In addition, 43% (23 occurrences) relate to failures in tracking timeline requirements in the Underwriting/Restructuring Plan phase.

Class 2 – Project File Products

Class 2 comprised of findings of noncompliance with M2M Program policies and procedures relating to restructuring documentation. OAHP requires PAEs to retain certain documents in the project files for each asset processed. The results of our test work indicated that the overall compliance rate was 96.3%. Alternatively, this equates to a noncompliance rate of 3.7% in which the PAEs failed to comply with eight requirements for documentation. As shown in Table 3, of the 116 assets tested, the frequency of noncompliance for each documentation requirement ranged from less than 5 to 39 occurrences. The types of these findings and distribution of occurrences by project files product attribute is presented in Table 3 and Figure 7. The predominance of findings in the Class, which represent three of the failures of noncompliance, relates to: Failure to obtain a report of title (title bring-down); inadequate code compliance information; and incomplete documentation certifying subsidy layering review.

Copies of initial title documents are sometimes submitted as original loan documentation. However, over the years, the Owners may have granted property rights such as easements or may have had liens placed against the property. Section 4-7 D, Chapter 4 of the OPG and Resource Desk Guidance dated August 1, 2001 require that PAEs obtain and review a report of title (title bring-down) during the due diligence stage to assist in determination of ownership structure and any encumbrances and to allow sufficient time to resolve any title issues. OAHP allows a reimbursement cost of up to \$500 per transaction for this process. If the title bring-down is not obtained during the data collection stage, there may not be enough time to resolve title issues such as major liens and loan modification before closing.

As part of the supporting materials in data collection, code compliance information is obtained to describe any violations unabated at the time of the restructuring and a history of corrected violations. Section 4-7.A, Chapter 4, of the OPG requires that the PAE contact the appropriate entity in the property's jurisdiction to obtain any available information regarding the project's compliance with applicable codes. If this is not addressed, there is a possibility that fire, building, and zoning code violations would go undetected and may undermine the effectiveness of the restructuring process.

Subsidy layering review is a statutory requirement under MAHRA §514(e)(7) designed to prevent multiple funding sources for the same property. PAEs must certify to OAHP that every restructuring plan submitted for approval meets the HUD subsidy layering requirement and that no overlaps of Sources and Uses were found. Failure to meet the requirement may result in excess financial assistance.

The other findings of noncompliance in this Class, which represent the remaining five requirements, relate to missing or incomplete owners' data for miscellaneous activities in the restructuring, including owner's certification, owner's adoption of PAE's PCA, related party checklist, and notification to tenants and other interested parties of the completed restructuring plan. The requirements for this documentation are provided in Section 3-9, Chapter 3; Section 4-2, Chapter 4; Section 4-8, Chapter 4; and Section 4-9, Chapter 4, of the OPG. These documents are necessary to define each party's rights and obligations in the restructuring process. Failure to complete them undermines the efficiency and effectiveness of the M2M Program.

Table 3: Class 2 – Project File Product Findings

Types of Project File Product Findings	Reporting Attribute	No. of Occur- rences
E: Report of Title (title bring-down) was not		
obtained during due diligence stage.	Due Diligence	39
F : Code compliance information was not	Supporting	
obtained as required.	Materials (SM)	22
G : Subsidy layering review did not meet HUD's	Supporting	
certification requirement	Materials (SM)	18
H : No letter from PAE to Owner transmitting	Owner's	
owner's certification requirement	Package (OP)	5
I: Others – four incomplete documentation for	Tenant &	
miscellaneous restructuring activities with a	Owner's Meet/	4
frequency less than 5	SM /OP	
Total Occurrences		88



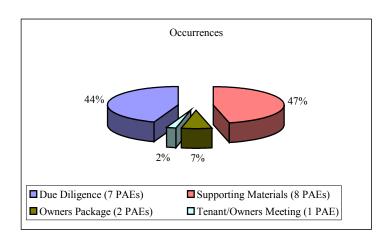


Figure 7: Class 2 – Occurrences by Project File Product Attributes

As illustrated in Table 3 above, the eight project file product findings comprised 88 occurrences. The distribution of these findings illustrated in Figure 7 above indicates that 47% (41 occurrences) relate to incomplete/missing documentation in Supporting Materials attribute. Additionally 44% (39 occurrences) relate to Due Diligence attribute; 7% (6 occurrences) relate to Owner's Package attribute; and 2% (2 occurrences) relate to Tenant/Owner's Meeting.



Class 3-Administrative Process

Class 3 comprised of findings related to the failure of PAEs to adequately oversee third-party contracts as prescribed in the PRA and comply with applicable M2M Program policies and procedures for administrative file maintenance. The results of our test work indicated that the overall compliance rate was 89.6%. Alternatively, this equates to a noncompliance rate of 10.4%, which represents 6 occurrences. From the 17 PAEs reviewed, the frequency of noncompliance with the administrative process ranged from 1 to 6 occurrences. The distribution of these occurrences by process attribute is presented in Figure 8. These findings, which are based on individual PAE processes (notwithstanding the number of assets tested), relate to lack of three-bid procurement, erroneous billing, and inadequate teaming partner oversight.

HUD reimburses PAEs for costs associated with specified subcontractors' activities. Article 9.2.1 of the PRA requires PAEs to obtain at least three bids in their procurement process or obtain prior approval for any alternative competitive procurement process. The lack of a competitive procurement process undermines the effectiveness of the M2M program and may influence the opportunity to obtain best value; taking into consideration cost, quality, and delivery.

As provided in Section 2-3 C.6, Chapter 2, of the OPG and Article 9.2.2 of the PRA, PAEs are required to submit single original invoices for only one claim per service. Failure to comply with these requirements increases risk of improper payments.

Notwithstanding the PAEs right to enter into teaming partner subcontracts, Article 7 of the PRA requires the PAE to monitor and diligently supervise the teaming partner's performance and remain solely responsible and liable for the proper and timely performance of the services of their agreement. Failure to provide adequate oversight raises concerns regarding PAEs' involvement in the M2M program as policy changes or underwriting recurring themes may not be addressed on time.



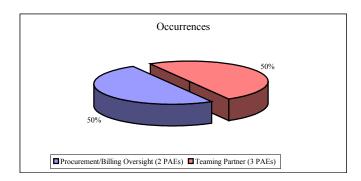


Figure 8: Class 3 – Occurrences by Administrative Process Attribute

As noted above, the frequency of PAEs' noncompliance with the administrative process resulted in 6 occurrences. The distribution of these findings illustrated in Figure 8 above indicates that 50% (3 occurrences (involving 2 of the 17 PAEs), relate to failure in Procurement/Billing Oversight; while the other 50% (3 occurrences involving 3 of the 17 PAEs) relate to failure in Teaming Partner Oversight.



Nationwide Results

The results of our review of the sampled PAEs and assets are projected to the entire PAE and asset populations. The cumulative results of our test work offer significant perspective on the PAEs' compliance with the laws, regulations, and guidelines of the M2M Program.

We present the projected results according to the classes of findings and their related attributes. As noted in the *Executive Summary* section of this report, based on the attributes tested, we estimate that Timeline Reporting had a compliance rate of 93%, Project Files Products had a compliance rate ranging from 96% to 100%, and PAE Administrative Processes had a compliance rate of 90% to 100%. The compliance rates identified above, based on 99% confidence level of the results, indicate that the PAEs are substantially adhering to the requirements of the MAHRA, the OPG and the PRA on a nationwide basis. They further indicate that OAHP has been effectively monitoring the PAEs' M2M restructuring activities.

A description of each attribute tested and the projected results are detailed below:

Class 1 – Reporting Timeline Process:

• Attribute: Timing

We verified the accuracy of the reported critical dates. We estimate that the exception rate for this attribute is 6.76%; and, in addition, we are 99% confident that the true exception rate as a whole is not more than 7.64%.

Class 2 – Project File Products:

• Attribute: Restructuring Plan Package

We verified the existence of plan narratives on PAE's conclusions relating to ownership, market rents, net operating income, mortgage information and evaluation of the physical condition of the property. We estimate that the exception rate for this attribute is 0.00%; and, in addition, we are 99% confident that the true exception rate as a whole is not more than 0.00%.

• Attribute: Tenant and Community Comments

We confirmed tenant and community comments for 1st and 2nd tenant meetings. We estimate that the exception rate for this attribute is 0%; and, in addition, we are 99% confident that the true exception rate as a whole is not more than 0%.



• Attribute: Supporting Materials

We confirmed that the PAE documented information on rental Assistance and assessment plan, loan information, financial assessment and third-party reports. We estimate that the exception rate for this attribute is 2.40% and, in addition, we are 99% confident that the true exception rate as a whole is not more than 2.67%.

• Attribute: Owner's Package

We verified the existence of ownership documentation, including loan history statement, related party checklist, insurance, major repairs, subordinate debt, and use restriction and agreements. We estimate that the exception rate for this attribute is 0.91%; and, in addition, we are 99% confident that the true exception rate as a whole is not more than 1.39%.

• Attribute: Other Supporting Information

We verified the existence of miscellaneous restructuring documentation, including asset information from HUD, evaluation of management, transmittal of approved or rejected restructuring plan and commitment. We estimate that the exception rate for this attribute is 0.00%; and, in addition, we are 99% confident that the true exception rate as a whole is not more than 0.00%.

• Attribute: Closing File

We verified the existence of closing file correspondences, notifications and certifications relating to closing activities. We estimate that the true exception rate for this attribute is 0.00%; and, in addition, we are 99% confident that the true exception rate as a whole is not more than 0.00%.

Attribute: Closing Docket

We verified the completeness of the closing docket, including the transmittal letter and documentation related to mortgage, rehabilitation funding, multifamily claims, insurance, Use Agreements, Section 8 documents, and additional documents. We estimate that the exception rate for this attribute is 0.00%; and, in addition, we are 99% confident that the true exception rate as a whole is not more than 0.00%.

• Attribute: Conflict of Interest

We confirmed that PAEs had established procedures to identify conflicts of interest. We estimate that the exception rate for this attribute is 0.00%; and, in addition, we are 99% confident that the true exception rate as a whole is not more than 0.00%.

• Attribute: Owner Eligibility

We verified the determination of eligibility check and notification to OAHP. We estimate that the exception rate for this attribute is 0.00%; and, in addition, we are 99% confident that the true exception rate as a whole is not more than 0.00%.

• Attribute: Tenant/Owner Meetings and Required Notices
We verified the existence of documentation relating to tenant
and owner communications, including kick-off meetings,
notices for first and second tenant meetings, and notices to
local government. We estimate that the true exception rate for
this attribute is 0.22%; and, in addition, we are 99% confident
that the true exception rate as a whole is not more than 0.32%.

• Attribute: Due Diligence/Data Collection

We verified that the PAEs obtained the owners' documents, lender records, HUD asset management records, report of title, insurance and tax information, and bond documentation or determined whether they could proceed without them. We estimate that the exception rate for this attribute is 3.39%; and, in addition, we are 99% confident that the true exception rate as a whole is not more than 4.31%.

• Attribute: Underwriting

We verified the existence of documentation relating to the PAEs' requests for exception rent limitation waivers and discussions with the Owner, existing mortgagee, or proposed new lender. We estimate that the exception rate for this attribute is 0.00%; and, in addition, we are 99% confident that the true exception rate as a whole is not more than 0.00%.

• Attribute: Mortgage Restructure Approvals

We verified the submission and approval of the restructuring plans and commitment. We estimate that the exception rate for this attribute is 0.00%; and, in addition, we are 99% confident that the true exception rate as a whole is not more than 0.00%.

• Attribute: Documentation Distribution and Conversion
We verified the distribution of closing documents, the existence of acknowledgment letters from pertinent parties, confirmed post-closing internal review and verification of funds disbursement. We estimate that the exception rate for this attribute is 0.00%; and, in addition, we are 99% confident that the true exception rate as a whole is not more than 0.00%.



Class 3 – Administrative Processes:

• Attribute: Contract File Processes

We evaluated the PAE's processes and procedures for contract file maintenance, including PAE conflict of interest, closing/post-closing management and training. We estimate that the exception rate for these attributes is 0.00%; and, in addition, we are 99% confident that the true exception rate as a whole is not more than 0.00%.

Attribute: Procurement, Subcontractor Oversight, and Invoicing Processes

We evaluated the PAEs' procedures and oversight of third party contractors, including procurement and invoicing, and cost reimbursements. We estimate that the exception rate for this attribute is 1.90%; and, in addition, we are 99% confident that the true exception rate as a whole is not more than 2.47%.

• Attribute: Teaming Partner Oversight

We evaluated the PAE's internal procedures for approval of restructuring plans and the monitoring and supervision of the duties of its teaming partner. We estimate that the exception rate for these attributes is 10.34%; and, in addition, we are 99% confident that the true exception rate as a whole is not more than 18.89%.



Conclusion

Based on the procedures performed, and the overall results, we determined that the PAEs were in substantial compliance with the restructuring requirements of the M2M Program. We, therefore, conclude that OAHP has been effectively monitoring the nationwide restructuring activities.

Although we found substantial compliance with the restructuring requirements of the M2M Program, the results of our test work identified findings and management practices and conditions, which require consideration by OAHP. These findings indicate opportunities for improving the restructuring process. Implementation of our recommendations would enhance the effectiveness of the PAEs' activities in the restructuring process. These *Recommendations* are discussed below.

In order to ensure continued success of the M2M program, we suggest that OAHP continue its periodic and annual review programs to maintain the quality of contractor products and the efficiency of the program.

Recommendations

1. Controls Over Stipulated Timeline Events Should Be Improved

We noted that for 13 of the 17 PAEs reviewed, there were failures to comply with the timelines requirements stipulated by the OPG and the PRA. These occurrences included failures to hold the 2nd tenant's meeting at least ten days before submitting a restructuring plan to OAHP, failures to submit restructuring plans within 210 days of acceptance, failures to close restructuring transaction within 365 days of acceptance, and failures to submit closing dockets to OAHP within 65 days of closing.

According to PAEs, these failures resulted from a variety of reasons including delays in obtaining documentation or information from Owners and other parties. They also noted that owners are occasionally un-cooperative, resulting in the rescheduling of the second tenant meetings. In instances where a teaming partner relationship exists, the PAEs, in some cases, failed to adequately to monitor the teaming partner's performance with respect to the closing phase. Many of the PAEs attributed the delays in the submission of closing dockets with their decision or their closing agents' decisions to wait for the return of some recorded documents.

OAHP's timelines are designed to complete a restructuring concurrent with the expiration of the existing Housing Assistance Payment (HAP) contract. OAHP has estimated the time required to complete each phase of a restructuring transaction, taking into consideration the time necessary for OAHP's reviews of the work products. Delays in completing certain phases can have a negative effect on the total time to complete the restructuring and may result in closing occurring after the stipulated time.

Recognizing that delays may occur that are beyond the control of the PAEs, OAHP has implemented procedures by which the PAEs may apply for additional time to complete certain phases of the restructuring through the use of waivers. We recommend that OAHP strictly enforce its timeline policies through additional monitoring of PAE performance and issuance of notices of non-compliance where appropriate. We further recommend that OAHP consider establishing a waiver policy for the submission of closing dockets since the current OPG has no provisions for waivers for this event and, in some cases, time extensions may be warranted.

2. Report of Title (Title Bring-Down) Should Be Obtained During the Due Diligence Phase

We noted that for 7 of the 17 PAEs, Title Bring-Down Reports were not obtained during the due diligence phase of the restructurings as required in the OPG and the Resource Desk issuances. A Title Bring-Down Report discloses ownership changes, liens, easements, or other issues that may have occurred subsequent to the original HAP contract.

The PAEs stated that they relied on discussions with the Owners or their attorneys or reviews of documents on file with HUD to determine whether there were title issues, liens, or easements that required consideration in the development of the restructuring plan. The PAEs placed greater emphasis on obtaining the title reports during the closing phase of the restructurings.

While the PAE inquiry procedures may provide them with some level of comfort that there are no issues, more reliable information must be obtained from a title search performed during due diligence. Obtaining the title report during due diligence ensures that financial issues are included in the restructuring plan and other legal matters are identified and addressed so as not to delay closing.

We recommend that OAHP require that each title bring-down be ordered within the same timeframe listed in the PRA for other required third-party reports such as PCAs and appraisals. OAHP should also consider adding this title bring-down requirement to the Transaction Review process to ensure compliance.

3. Code Compliance Inquiries of Local Building Codes Should Be Adequately Documented

We noted that 4 of 17 PAEs reviewed did not document code compliance information in accordance with the OPG. These instances of noncompliance were evidenced by a lack of records being maintained to indicate contact with any local building, fire, or other enforcement authorities, to determine if there are outstanding or recent code violations. The OPG requires that inquiries be made of the appropriate local officials to determine whether there are any outstanding unabated violations or whether there have been recent violations that have not been corrected.

PAEs often rely on the Physical Condition Assessment (PCA) and the PCA inspectors to obtain information regarding code compliance. Some PCA reports assess code compliance through the application of general or national codes. Most PCA Reports may briefly mention the code compliance work but do not present sufficient detail of the procedures performed or the results. These PCA inspectors may not be knowledgeable of local codes or may not detect recent code violations that have not been repaired. If code compliance requirements are not strictly followed, there is the risk that fire, building and zoning code violations could go undetected and could undermine the effectiveness of the restructuring process.

We recommend that OAHP issue specific guidance on the procedures for obtaining and documenting code compliance information. These procedures should include documentation to describe any violations, unabated at the time, and a history of corrected violations. When this task is delegated to a PCA Inspector, the PCA should clearly address code compliance in the report and include the names of the regulatory agencies contacted, individuals' titles, date, or other identifying information. If no response is received, the PCA should state that fact and describe any other procedures performed to ensure that the property complies with local codes. OAHP should periodically monitor and remind the PAEs that it is their responsibility to ensure that PCA reports are properly reviewed to ensure that code compliance information meets the requirement.

4. Subsidy Layering Review Should Be Documented in Accordance with HUD's Certification Requirements

We noted that for 3 of the 17 PAEs reviewed, there was insufficient documentation to support the required subsidy layering review and certification. MAHRA requires this analysis and certification to

ensure that a property is not receiving overlapping assistance. This lack of documentation occurred where the determination for each restructuring did not meet HUD's certification requirement to ensure that all sources have been identified and reflected in the Source and Use Statement.

The general reason provided by PAEs' management indicated that a subsidy layering review was not necessary since claims payment does not involve excess federal subsidy. Failure to perform and document the review, as required, could result in potential overlapping or multiple funding sources for the same property and receipt of excess financial assistance.

We acknowledge that OAHP has recently developed standardized forms, Form 5.4 and Form 5.5, to address a part of this issue. We recommend that OAHP continue to monitor compliance with the requirement to ensure that the PAEs specifically report the subsidy layering analysis performed and certify the completion of such analysis in accordance with HUD's certification requirement.

5. Document Maintenance in the Restructuring Process Should Be Improved

We noted instances of missing or incomplete documentation for 4 of the 17 PAEs reviewed. These PAEs did not maintain project files in accordance with the OPG. These instances of noncompliance relate to various other activities in the restructuring process, including ownership certification, owner's adoption of PAE's PCA, related parties checklist, and notification to tenants and other interested parties of completed restructuring plans.

According to PAEs' management, most of these failures resulted from a lack of management quality control. In some instances, the documents were inadvertently omitted or misplaced and, in other instances, follow-up with Owners was not performed to ensure that the documents were executed.

We recommend that OAHP emphasize to the PAEs the importance of completing the required documents, since, in some cases, these are necessary for defining each party's rights and obligations in the restructuring process. Since the predominance of these findings relate to due diligence, OAHP could ensure compliance by requiring the PAEs to submit certain documentation attesting to the completion of the due diligence requirement along with their invoice for payment.



6. PAE Administrative Processes Should Be Improved

We noted failures in the administrative processes for 4 of the 17 PAEs reviewed. These PAEs did not to maintain effective administrative processes in accordance with the OPG and PRA as required. These include inadequate management of teaming partners and failures to document procurement procedures for third-party subcontractors.

Some of the reasons provided by PAEs included the assertion that supervision of subcontractors has been informal, which may lead to lapses in control oversight. With regard to teaming partner arrangements, PAEs are responsible for the performance of all restructuring activities, regardless of whether a Teaming Partner may actually be performing those activities. Failure to provide adequate oversight constitutes ineffective management, which may undermine the effectiveness of the M2M program. In instances where there were procurement failures, they noted that documentation could not be located and communication of information necessary for corrective action by both the PAE and OAHP has been ineffective. The lack of a competitive process may influence the opportunity to obtain best value contract service.

We recommend that OAHP ensure that the PAEs adhere to PRA guidelines regarding teaming partners' subcontracts. PAEs should establish procedures to document their teaming partner reviews such as obtaining written reports on the status of projects. In addition, OAHP should ensure that all issues regarding restructuring are communicated directly to the PAE and not only to the teaming partner to ensure their involvement in the restructuring of each asset.

We recommend that OAHP require that PAEs enhance their procedural control to ensure that procurement is done through an acceptable and competitive process. We also recommend that PAEs maintain adequate documentation in files or submit written request for an alternate process to OAHP for approval.



Other Matters

In conjunction with the performance of fieldwork on the 17 compliance audits and Agreed-Upon-Procedures reviews, we observed several matters that we believe should be communicated to OAHP's management. These matters, in connection with the application of the procedures that we agreed to perform, depict varying practices by PAEs and require further consideration by OAHP.

Post Closing Polices and Procedures Regarding Funds Disbursement Should Be Enhanced

The PAEs have varying procedures for monitoring the disbursement of funds during closing. For instance, some PAEs do not maintain any documentation of funds disbursed by the escrow agent, including excess funds that should be refunded to HUD. The PAEs indicated that no specific guidance is provided in the OPG and that they rely on the final settlement statement for details of the funds disbursed. These statements, however, were not always maintained in the asset files. PAEs also do not have procedures to ensure that any remaining escrow funds are not held indefinitely.

Lack of accountability over escrow funds increases the risk that funds may not be applied or received by appropriate parties as required.

To address these issues and to ensure that all funds have been disbursed to the appropriate parties or are accounted for, OAHP has designed and implemented Form 7.21 to document and obtain additional information from the PAEs and the closing agents on closing account transactions.

We recommend that OAHP establish a post-closing review of the status of escrow funds to ensure that PAEs have procedures to monitor the close out and final disbursement of all escrow funds. In addition, PAEs should obtain copies of wire confirmation or checks for the disbursement of funds by the Escrow Agent. This documentation should be filed in the closing docket.

Critical Date Tracking Report/MIS System Should Be Improved

During our reviews of timeline reporting, we noted the following in the Critical Date Tracking Report generated from the MIS system:

 There were no data fields in the MIS system to record the dates for Closing Docket Submission

- Control features in the MIS system were not adequate to identify omissions of critical data upon completion of a reporting phase. Specifically, we noted one instance where the critical date tracking report was completed up to the postclosing phase but the date of 2nd Tenant Meeting was missing
- There were inconsistencies in tracking the milestones for Restructuring Plan Submission. On the MIS Critical Dates Tracking Report, some PAEs used the "Initial PAE Restructuring Plan Submission to OAHP" while OAHP used "PAE Submits Restructuring Plan to OAHP" since their determination for the 210-day plan submission requirement was met by submission of an "approvable plan". However, although the plan may be considered approvable, any minor changes in the model would require an electronic resubmission, which would trigger a change to the original submission date. The new date often results in a date that would reflect a default in timeline; and, although another phase in the Critical Dates Tracking Report captures resubmission date, the system does not recalculate and adjust the milestone from the original submission date

The MIS system supports OAHP's internal and external reporting on Program statistics and cost reimbursements. In this regard, accurate reporting and adherence to established timelines are critical to ensuring that restructuring is completed efficiently and effectively.

We recommend that OAHP review the MIS data fields and the parameters for entering milestones to ensure that management reports accurately reflect the status of each restructuring. The MIS system should be modified to facilitate end user tracking and reporting of critical dates, including the date for closing docket submission to OAHP.

Furthermore, to enhance the system controls, we recommend that required data fields be identified and completeness checks be designed in the system to ensure that stages of the report are not completed without these required data.

OAHP should provide a clear policy on the criteria that form the basis of tracking milestone for Plan Submission. The PRA requirement should be updated to reflect a clear and unequivocal statement that would be practical to test in the MIS system.

Guidance on Semi-Annual Report to OAHP Should Be Updated

We noted varying practices by PAEs regarding the requirement on semi-annual reporting to OAHP for housing assistance renewals. Appendix M of the OPG indicates that PAEs should report semi-annually on those projects that, either 'renew project-based assistance despite tenant support for tenant-based assistance during the tenant consultation process or renew with tenant-based assistance'. Most PAEs do not submit this report on the basis that they do not have any projects that meet the criteria. In addition, some PAEs indicated that the information required is discussed in the 'rental assistance assessment plan' and through tenant survey for each project.

We recommend that OAHP issue guidance to clarify the reporting requirement, including a standardized format. In those reporting periods where no condition resulted in renewal of project-based assistance despite tenant support for tenant-based assistance, we recommend that PAEs provide a negative semi-annual report to OAHP to document that they have reviewed their transactions and none meet the criteria.



Prior Year Findings

During the performance of our fieldwork, we conducted a follow-up review of prior year findings, which we considered necessary to communicate to OAHP's management. The following table describes the number of findings reported in the prior year, 2003, compliance audits and AUP reviews and the current status of the findings based on the PAEs revisited. We did not review the asset files from which these findings were generated, rather we determined whether corrective actions were taken through interviews with PAEs and review of the current files.

Table 5: Analysis of Prior Year Findings

		Cla	%		
Details		Time- line Reports	Project Files Product	Admin Process	Status
Number of Current Year PAEs with Prior Year Findings	13				
Total Findings Reported	95	52	36	7	
Total Findings Closed	72	30	35	7	76%
Total Repeat Findings	23	22	1	0	24%

The analysis in Table 5 above indicates that, of the 95 findings reported from the 13 PAEs visited in 2003, 72 (76%) findings were considered closed and 23 (24%) findings were repeat conditions. From the repeat conditions, 96% (10 of 13 PAEs) relate to timeline failures and 4% (1 of 13 PAEs) relate to project files product failures. We noted that most of the repeat findings relate to noncompliance with 65 days closing docket submission requirement in which 8 of the 13 PAEs revisited did not take adequate corrective action since the prior year.

In regard to corrective actions on findings closed, we noted significant improvement in the completion of Owner's Adoption of PAE's PCA (Form 4.7) in the current files reviewed. Based on the number of assets reviewed and occurrences, we noted that the noncompliance rate fell from 30% in the prior year to 1% in the current year.

Over the last three years, the overall error rate (based on number of occurrences and procedures tested) ³ has decreased from 1.56% to 1.08% as shown in Table 6.

Table 6 - Overall Error Rate for Past Three Years

	Error Rate Summary			
Class of Findings	2002	2003	2004	
Timeline Reporting	7.62%	12.32%	6.76%	
Project Files Product	1.00%	0.78%	0.71%	
Contract /Admin Processes	0.89%	1.08%	1.40%	
Total	1.56%	1.79%	1.08%	



Timeline Reporting continued to have the highest error rate since over the years restructuring became more difficult to process within the stipulated 12-month period. Such difficulties are encountered where Owners are reluctant to restructure their mortgages and, instead, choose to accept the rent reductions without restructuring or where the properties are in need of substantial repairs. As a result of the high error rate, OAHP improved its processing of waiver requests and began enforcing the contract terms more aggressively to achieve higher compliance. The error rate declined from 7.62% in 2002 to 6.76% in 2004.

A decline in the error rates for Project Files Products was noted over the past three years from 1.00% in 2002 to 0.71% in 2004. It appears that adequate corrective action has been taken to prevent repeat occurrences. Significant improvement was noted in the collection and documentation of owners' data and supporting materials such as Owner's Adoption of PAE's PCA, Loan History Statement, and Checklist of Related Party Agreement.

In the case of Contract/Administrative Processes, an increase in the error rate was noted over the past three years from 0.89% in 2002 to 1.40% in 2004. The error rate increased due to increase in the number of PAEs reviewed, which included PAEs not previously visited, and findings from the inclusion of new test procedures relating to teaming partner oversight.

In general, the overall decline in error rates is attributed to OAHP's continuous monitoring of the PAEs' restructuring activities and modification of its policies and procedures to improve the efficiency and effectiveness of the program. In addition, the PAEs respond favorably to these evaluations and modify their internal procedures to achieve higher compliance with the requirements.

³See Procedures for Error Rate at Appendix A



Appendix A

Statistical Sampling Methodology

Regis & Associates, PC retained Dr. Gary Anderson as its statistician to determine appropriate sampling processes and associated statistical techniques for the evaluation of PAE performance as a whole. Our sample selection was based on a population of 342 "Full" asset restructurings that were "Accepted" and "Approved but Not Closed" or "Closed" between January 1, 2003 and May 31, 2004. We determined that sampling 116 restructuring transactions (34% of the above population) at 17 PAEs would provide sufficient data to compute estimated error rates to within 1% with 99% confidence interval.

We developed a sampling methodology that would statistically support projections of the actual exception occurrences in our sample to the total population of PAEs. We augmented the basic statistical sample to aid in identifying internal control weaknesses and noncompliance occurrences with the specific attributes required in the Statement of Work.

OAHP specified that all PAEs that processed restructurings meeting the criteria above be reviewed in the current review cycle. Seventeen of the twenty-two PAEs had restructurings eligible for review. In selecting the sample size of 116 assets, we applied a sampling rate of 100% for PAEs with four or fewer eligible restructurings and a sampling rate ranging from 80.0% to 30.3 % for PAEs with five or more eligible restructurings.

We tabulated the results of each procedure in the AUP checklist and consolidated the results of all assets tested from all the PAEs reviewed to determine the number of errors. We calculated sample error rates by dividing the number of "No" responses (representing an error) by the Total responses excluding "Not Applicable" responses, which are considered statistically neutral. We performed standard statistical procedures to the sample error rates to determine the confidence intervals with a precision of 99%.



Appendix B

Listing of Selected Participating Administrative Entities

	PAE Name	Location
1	Colorado Housing Finance Agency	Denver, CO
2	CreditVest, Inc.	Pittsburgh, PA
3	First Housing Development Corporation	Tampa, FL
4	Foley and Judell, LLP	New Orleans, LA
5	Heskin/Signet Partnership	Denver, CO
6	Indiana Housing Finance Authority	Indianapolis, IN
7	Jefferson County Assisted Housing Corporation	Birmingham, AL
8	Kitsap County Consolidated Housing Authority	Seattle, WA
9	Louisiana Housing Finance Agency	Baton Rouge, LA
10	NW Financial Group	Jersey City, NJ
11	New Mexico Mortgage Finance Authority	Albuquerque, NM
12	North Carolina Housing Finance Agency	Raleigh, NC
13	North Dakota Housing Finance Agency	Bismarck, ND
14	Ontra, Inc.	Austin, TX
15	Real Estate Recovery, Inc.	Herndon, VA
16	The Siegel Group, Inc.	Austin, TX
17	Utah Housing Corporation	Salt Lake City, UT



Appendix C

PAE Report Types and Sample Selection

PAE	Review Type	Population	Sample
		_	
CreditVest, Inc.	Audit	42	13
Foley and Judell, LLP	Audit	29	9
Indiana Housing Finance Authority	Audit	3	3
Jefferson County Assisted Housing Corporation	Audit	8	4
Louisiana Housing Finance Agency	Audit	9	4
North Carolina Housing Finance Agency	Audit	5	4
NW Financial Group	Audit	33	10
Compliance Audit Total	7	129	47
Colorado Housing Finance Agency	AUP	2	2
First Housing Development Corporation	AUP	22	7
Heskin/Signet Partnership	AUP	54	16
Kitsap County Consolidated Housing Authority	AUP	9	4
New Mexico Mortgage Finance Authority	AUP	2	2
North Dakota Housing Finance Agency	AUP	1	1
Real Estate Recovery, Inc	AUP	44	12
Ontra, Inc	AUP	40	13
The Siegel Group, Inc	AUP	38	11
Utah Housing Corporation	AUP	1	1
AUP Review Total	10	213	69
TOTAL	17	242	11(
TOTAL	17	342	116



Appendix D

Summary of Statistical Analysis

Attributes	Population	Sample	Number of Procedures Performed	Number of Exceptions	Error Rate	Confidence Intervals @99%
	C	lass 1 – Repor	ting Timelines			
Timing	342	116	1,044	53	6.76	(5.88, 7.64)
		2 D : 4	E1 0 D 1 4			
			File & Products			
Restructuring Plan Package	342	116	812	0	0.00	(0.00, 0.00)
Tenant &Community Comments	342	116	580	0	0.00	(0.00, 0.00)
Supporting Material	342	116	1,972	41	2.40	(2.14, 2.67)
Owners Package	342	116	1,160	6	0.91	(0.43, 1.39)
Other Supporting Information	342	116	3,248	0	0.00	(0.00, 0.00)
Closing File	342	116	1,624	0	0.00	(0.00, 0.00)
Closing Docket	342	116	12,180	0	0.00	(0.00, 0.00)
Conflict of Interest	342	116	116	0	0.00	(0.00, 0.00)
Owner Eligibility	342	116	116	0	0.00	(0.00, 0.00)
Tenant/Owner Meetings Required Notices	342	116	1,044	2	0.22	(0.11, 0.32)
Due Diligence/ Data Collection	342	116	1,508	39	3.69	(3.07, 4.31)
Underwriting	342	116	464	0	0.00	(0.00, 0.00)
Mortgage Restructure Approvals	342	116	464	0	0.00	(0.00, 0.00)
Documentation Distribution and Conversion	342	116	1,508	0	0.00	(0.00, 0.00)
Total Project File Products			26,796	88		
	Class 3 –	Administrativ	ve Processes (By F	PAE)		
Contract Processes	17	17	272	0	0.00	(0.00, 0.00)
Procurement/Contractor Oversight/Billing	17	17	170	3	1.90	(1.33, 2.47)
Teaming Partner Oversight	17	17	68	3	10.34	(1.80, 18.89)
Total Administrative Process			510	6		
Totals			28,350	147		

Note: Where the number of exceptions was zero, since only a sample of transactions was selected, qualitatively it is likely that the overall percentage of errors is small.

REGIS ASSOCIATES, PC

Appendix E

Summary Result of Supplementary Review

OAHP originally intended to review transactions at all PAEs having an active portfolio of assets as of May 31, 2004 meeting certain acceptance and approval criteria as described in the Scope and Methodology section above. Based on those criteria, 17 PAEs were selected. OAHP subsequently identified an additional PAE for review that had a transaction that was accepted prior to 2003, approved during the period January 1, 2003 to May 31, 2004, and subsequently closed.

Since the scope and sample methodology for this additional review was not consistent with the initial 17 PAEs, the results of the review are not included in this report. The results of that review did not disclose any findings that were significantly different from those identified in the review of the initial 17 PAEs.

We have communicated the detailed results of that review in a separate report to the PAE and OAHP.

